

ORIGINAL

BERNSTEIN LITOWITZ BERGER
& GROSSMANN LLP
Blair A. Nicholas (Bar No. 178428)
blairn@blbglaw.com
Timothy A. DeLange (Bar No. 190768)
timothyd@blbglaw.com
Niki L. Mendoza (Bar No. 214646)
nikim@blbglaw.com
Takeo A. Kellar (Bar No. 234470)
takeok@blbglaw.com
12481 High Bluff Drive, Suite 300
San Diego, CA 92130
Tel: (858) 793-0070
Fax: (858) 793-0323

KAHN SWICK & FOTI, LLC
Kim E. Miller (Bar No. 178370)
kim.miller@ksfcounsel.com
Melissa Ryan Clark (*Pro Hac Vice*)
melissa.clark@ksfcounsel.com
Michael A. McGuane (*Pro Hac Vice*)
michael.mcguane@ksfcounsel.com
500 5th Ave., Suite 1810
New York, NY 10110
Tel: (212) 696-3730
Fax: (504) 455-1498

[additional counsel on signature page]

Co-Lead Counsel for Lead Plaintiffs

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

IN RE STEC, INC. SECURITIES
LITIGATION

Lead Case No.
SACV 09-01304-JVS (MLGx)

CLASS ACTION

By Fax

This Document Relates To:

**CONSOLIDATED COMPLAINT FOR
VIOLATIONS OF THE FEDERAL
SECURITIES LAWS**

ALL ACTIONS

DEMAND FOR JURY TRIAL

FILED

2010 APR -9 PM 3:32

CLERK OF COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION
San Diego, CA 92130
Tel: (619) 531-3000
Fax: (619) 531-3001

TABLE OF CONTENTS

	Page
I. NATURE AND SUMMARY OF THE ACTION	1
II. JURISDICTION AND VENUE	4
III. THE PARTIES	5
A. Lead Plaintiffs	5
B. Defendants	5
IV. CONFIDENTIAL WITNESSES	7
V. THE FRAUDULENT CONDUCT	10
A. Background	10
B. STEC Concealed Its Agreements With Its Largest Customer	11
C. Defendants' Fraudulent Practices	14
1. Defendants Knowingly Shipped Empty Containers And Defective Product	14
2. Defendants Lied To Customers About STEC's Product Quality And Altered Reports To Improperly Record Revenue	15
D. Defendants Increase Guidance, Citing Purportedly Successful Zeus Sales	19
E. After Artificially Inflating The Price Of STEC Stock, Defendants Manouch And Mark Moshayedi Engaged In Massive Insider Selling	21
F. The Aftermath	24
VI. DEFENDANTS' FALSE AND MISLEADING STATEMENTS	25
A. STEC's Revenues From Zeus	25
B. The \$120 Million Supply Agreement For Zeus	29
C. STEC's Customer Base And Growth	30
D. STEC's Product Quality	36
E. STEC's Competition	37

1	F. STEC's Internal Controls And Compliance With GAAP And SEC.....	41
2	G. Materially False And Misleading Statements And Omissions Made As The Truth Began To Be Revealed	43
3	VII. THE TRUTH EMERGES	45
4	A. The September 17, 2009 Partial Corrective Disclosure	46
5	B. The November 3, 2009 Partial Corrective Disclosure	48
6	C. The February 23, 2010 Corrective Disclosure	56
7	D. Post-Class Period Developments	60
8	VIII. DEFENDANTS' GAAP VIOLATIONS	61
9	IX. APPLICABILITY OF PRESUMPTION OF RELIANCE: FRAUD ON THE MARKET DOCTRINE.....	66
10	X. NO SAFE HARBOR.....	67
11	XI. CLASS ACTION ALLEGATIONS.....	68
12	XII. CLAIMS FOR RELIEF	70
13	COUNT I For Violation Of § 10(b) Of The Exchange Act And Rule 10b-5 Against STEC, Manouch Moshayedi, Mark Moshayedi, And Raymond D. Cook	70
14	COUNT II For Violation Of § 20(a) Of The Exchange Act Against Manouch Moshayedi, Mark Moshayedi, And Raymond D. Cook.....	73
15	XIII. PRAYER FOR RELIEF	74
16	XIV. JURY DEMAND.....	75
17		
18		
19		
20		
21		
22		
23		
24		
25		
26		
27		
28		

1 The allegations contained herein are based upon information and belief with
2 information obtained through the investigation made by and through Lead Counsel.
3 Lead Counsel's investigation has included, among other things: (i) interviews of
4 confidential witnesses, including former employees of Defendant STEC, Inc.
5 ("STEC" or the "Company"), as well as third-parties, with specific and first-hand
6 knowledge of the events and practices alleged herein; (ii) review and analyses of
7 STEC's filings with the United States Securities and Exchange Commission
8 ("SEC"), press releases and other public statements; and (iii) review and analyses
9 of news, media and analyst research reports.

10 I. NATURE AND SUMMARY OF THE ACTION

11 1. Lead Plaintiffs, Keith A. Ovitt and Arman Rashtchi, bring this action
12 on their own behalf and on behalf of all persons and entities who purchased or
13 otherwise acquired STEC common stock between June 16, 2009 and
14 February 23, 2010 (the "Class Period"), and were damaged thereby. This action is
15 brought against STEC and its top executive officers, the Company's Chairman and
16 Chief Executive Officer ("CEO"), Manouch Moshayedi; its President, Chief
17 Operating Officer ("COO"), and Chief Technology Officer ("CTO"), Mark
18 Moshayedi; and its Chief Financial Officer ("CFO"), Raymond D. Cook
19 (collectively, the "Individual Defendants"), for violations of the Securities
20 Exchange Act of 1934 (the "Exchange Act").

21 2. The facts alleged herein are currently the subject of an ongoing
22 investigation by the SEC. STEC has revealed that certain of STEC's officers and
23 employees, including Defendants Manouch and Mark Moshayedi, have received
24 subpoenas in connection with the SEC's investigation.

25 3. STEC purports to be a leading global provider of memory and storage
26 solutions tailored to meet the high-performance, high-reliability needs of original
27 equipment manufacturers ("OEMs") like Sun Microsystems, EMC Corporation,
28 IBM, and Dell. During the Class Period, STEC's core business was its enterprise

1 scale solid-state drives (“SSD”), such as its flagship product, the ZeusIOPS SSD
2 (“Zeus”).

3 4. Throughout the brief eight month Class Period, Defendants knowingly
4 engaged in various fraudulent practices to dramatically increase STEC’s stock
5 price and create a window for the Company’s two most senior executives to sell
6 more than 9 million shares of stock, approximately 50% of their holdings, for
7 proceeds *in excess of \$267 million*. These fraudulent practices centered on
8 Defendants’ manipulation of the Company’s revenue and revenue guidance to
9 investors and the market – key metrics that determined STEC’s financial health.

10 5. On June 16, 2009, the first day of the Class Period, and again just one
11 month later in July 2009, Defendants announced a huge increase in STEC’s
12 revenue guidance. This news was a departure from STEC’s prior guidance, and the
13 stock price soared. Defendants explained that the guidance increases resulted from
14 growth in the Company’s sales of its flagship product, Zeus, and a \$120 million
15 deal with the Company’s largest customer, EMC Corporation (“EMC”) for third
16 and fourth quarters of 2009. Defendants highlighted that the increased revenue
17 growth and EMC deal were indicative of future sales and growth.

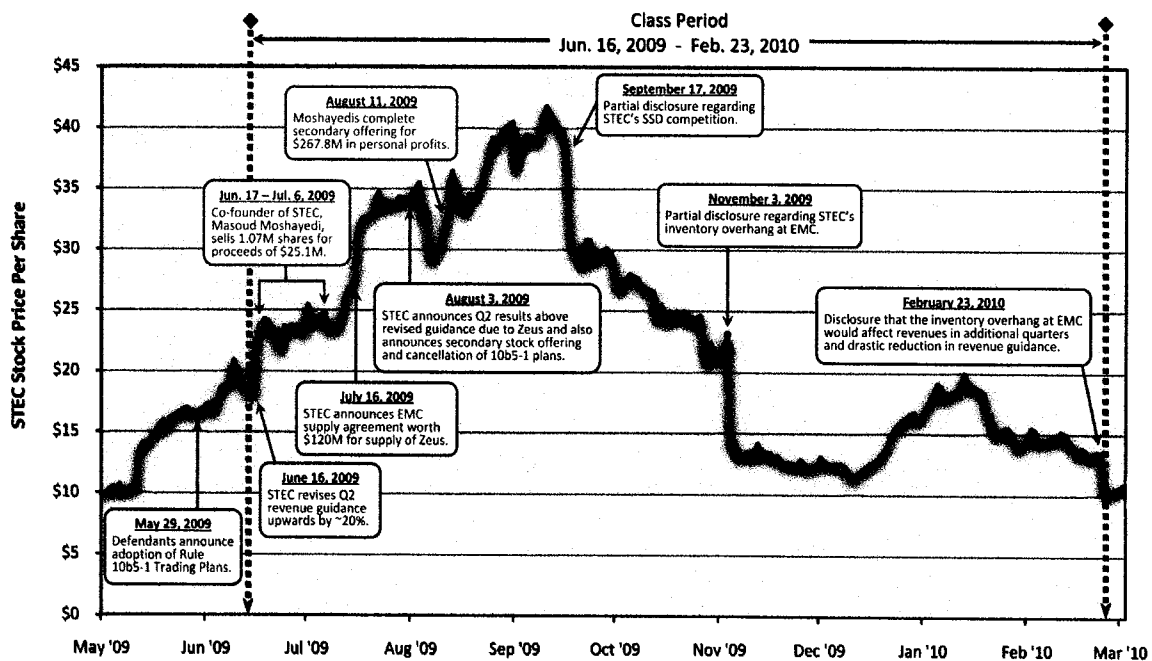
18 6. As the stock price rose to unprecedented levels, STEC’s two top
19 executive officers – its CEO and Chairman, Defendant Manouch Moshayedi, and
20 his brother, STEC’s President and COO, Defendant Mark Moshayedi – cancelled
21 their newly-adopted Rule 10b5-1 trading plans and sold 9 million shares of STEC
22 stock through a “secondary offering.”

23 7. Defendants Manouch and Mark Moshayedi completed their sale at
24 \$31 per share – nearly *double* STEC’s stock price just two months earlier at the
25 beginning of the Class Period. Defendant Manouch Moshayedi founded STEC in
26 1990, and Defendant Mark Moshayedi joined the Company shortly thereafter in
27 1992. Prior to this secondary offering, they had never previously sold such
28 massive amounts of their STEC stock. In fact, the shares sold by the Moshayedis

were, collectively, more than 11 times the number of shares they sold in the six months before the Class Period and 20 times the number of shares they sold in all of 2008. That was the largest insider selling in the history of the Company.

8. Defendants' manipulation of the Company's revenue and revenue guidance ended following the massive insider sales. As would be revealed through multiple partial disclosures beginning on September 17, 2009, STEC's purported increased revenue was derived from *a single customer*, in a *one-time deal* that – contrary to Defendants' misrepresentations – was not indicative of continuing demand for STEC's products. Following each of these announcements, STEC's stock price plummeted. STEC's stock price currently trades at \$11.76, below its price at the beginning of the Class Period, and 72% below the Class Period high.

9. As illustrated below, while STEC's stock price rose in just two months, the top executive officers unloaded their personally held shares near the all-time high, just one month before the truth began to emerge:



10. Thirteen confidential witnesses – including former STEC employees and customers with first-hand knowledge – confirm the existence of Defendants'

1 deceptive business practices which were specifically designed to inflate STEC's
2 financial results and artificially inflate its stock price. The confidential witnesses
3 confirm that Defendants engaged in the following fraudulent practices to inflate
4 STEC's stock price:

- 5 • "Shipping bricks": a term utilized internally at STEC to describe its
6 common practice in which the Company ships empty packages or
7 packages containing the wrong product, allowing STEC to immediately
8 record revenue at the end of a fiscal reporting period for product that was
9 not actually shipped;
- 10 • Demanding that customers accept inventory by a fiscal quarter's deadline
11 for recording revenue regardless of that customer's actual need for
12 STEC's products at that time;
- 13 • Shipping defective or untested product and immediately recording
14 revenue upon shipment despite knowledge that the product was defective
15 and untested;
- 16 • Selling product as "new" even though it contained refurbished or rejected
17 parts;
- 18 • Lying to customers about product quality, features, certifications, testing,
19 and failure rates;
- 20 • Altering error reports before sending them to customers; and
- 21 • Manipulating accounting for revenue from the EMC contract, including
22 by violating generally accepted accounting principles ("GAAP").

23 II. JURISDICTION AND VENUE

24 11. This action arises under Sections 10(b) and 20(a) of the Exchange Act,
25 15 U.S.C. §§ 78j(b) and 78t(a), and Rule 10b-5 promulgated thereunder by the
26 SEC, 17 C.F.R. § 240.10b-5.

27 12. This Court has jurisdiction over the subject matter of this action
28 pursuant to 28 U.S.C. § 1331 and § 27 of the Exchange Act, 15 U.S.C. § 78aa.

1 Venue is proper in this District pursuant to Section 27 of the Exchange Act, 15
2 U.S.C. § 78aa, and 28 U.S.C. § 1391(b). Defendant STEC maintains its principal
3 place of business within this District, the Individual Defendants conduct business
4 in this District, and many of the acts giving rise to the violations alleged herein,
5 including the preparation and dissemination of materially false and misleading
6 information and omissions, occurred in substantial part in this District.

7 13. In connection with the acts alleged in this Complaint, Defendants,
8 directly or indirectly, used the means and instrumentalities of interstate commerce
9 including, but not limited to, mail, interstate telephone communications, and the
10 facilities of the national securities markets.

11 **III. THE PARTIES**

12 **A. Lead Plaintiffs**

13 14. Lead Plaintiff Keith A. Ovitt purchased STEC common stock during
14 the Class Period. As a result of the unlawful conduct alleged herein, Mr. Ovitt
15 suffered damages in connection with his purchases of STEC common stock.
16 Attached hereto is a certification setting forth Mr. Ovitt's transactions in STEC
17 securities during the Class Period.

18 15. Lead Plaintiff Arman Rashtchi purchased shares of STEC common
19 stock during the Class Period. As a result of the unlawful conduct alleged herein,
20 Mr. Rashtchi suffered damages in connection with his purchases of STEC common
21 stock. Attached hereto is a certification setting forth Mr. Rashtchi's transactions in
22 STEC common stock during the Class Period.

23 16. Collectively, Mr. Ovitt and Mr. Rashtchi are referred to herein as the
24 "Lead Plaintiffs."

25 **B. Defendants**

26 17. Defendant STEC is a California corporation with its principal place of
27 business located at 3001 Daimler Street, Santa Ana, California. According to the
28 Company's profile, STEC purports to be a leading global provider of solid-state

1 computer memory drive technologies and solutions tailored to meet the high-
2 performance, high-reliability needs of OEMs. The Company claims to
3 manufacture the industry's "most comprehensive line" of SSDs in the storage
4 industry. Throughout the Class Period, the Company traded in an efficient market
5 on the NASDAQ under the ticker symbol "STEC." As of February 23, 2010, the
6 Company had nearly 50 million shares issued and outstanding.

7 18. Defendant Manouch Moshayedi, co-founder of STEC, is, and at all
8 relevant times was, Chairman of the Board and CEO of STEC. During the Class
9 Period, Defendant Manouch Moshayedi signed and certified the Company's SEC
10 filings pursuant to Sections 302 and 906 of the Sarbanes-Oxley Act of 2002
11 ("SOX"). During the Class Period, Defendant Manouch Moshayedi sold 4.5
12 million shares of his personally-held STEC stock, collecting nearly \$134 million in
13 insider trading proceeds.

14 19. Defendant Merhdad "Mark" Moshayedi, is, and at all relevant times
15 was, President, COO, CTO, Secretary and a Director of STEC. Mark Moshayedi
16 and Manouch Moshayedi are brothers (a third brother, Masoud "Mike" Moshayedi,
17 co-founded the Company, retiring in 2007 and remaining beneficial owner of 8.9%
18 of the total shares of STEC's common stock). During the Class Period, Defendant
19 Mark Moshayedi signed Company SEC statements, including the Company's
20 August 2009 Registration Statement and Prospectus. During the Class Period,
21 Defendant Mark Moshayedi sold 4.5 million shares of his personally-held STEC
22 stock, collecting nearly \$134 million in insider trading proceeds.

23 20. Defendant Raymond D. Cook is, and at all relevant times was, the
24 CFO and Principal Accounting Officer of the Company. During the Class Period,
25 Defendant Cook signed and certified the Company's SEC filings pursuant to
26 Sections 302 and 906 of SOX.

27 21. Defendants Manouch Moshayedi, Mark Moshayedi, and Cook,
28 because of their positions with the Company, possessed the power and authority to

1 control the contents of STEC's quarterly reports, press releases, and presentations
2 to securities analysts, money and portfolio managers, and institutional investors,
3 *i.e.*, the market. They were provided with copies of the Company's reports and
4 press releases alleged herein to be misleading prior to or shortly after their issuance
5 and had the ability and opportunity to prevent their issuance or cause them to be
6 corrected. Because of their positions with the Company, and their access to
7 material non-public information, the Individual Defendants knew or with
8 deliberate recklessness disregarded that the adverse facts specified herein were
9 being concealed from the public and that the positive representations being made
10 were then materially false and misleading. The Individual Defendants are liable
11 for the false and misleading statements pleaded herein.

12 IV. CONFIDENTIAL WITNESSES

13 22. The allegations herein are supported in part by first-hand accounts of
14 thirteen confidential witnesses, including former STEC employees and customers.
15 As set forth below, the confidential witnesses were each in a position to know the
16 information alleged, and many corroborate the allegations of one another. The
17 confidential witnesses have been identified with particularity but without
18 disclosing identities in order to address concerns about retaliation or career injury:

19 (a) Confidential Witness 1 ("CW1") was an STEC Sales and Field
20 Applications Engineer from September 2007 through November 2009. CW1
21 worked with top tier Network and Enterprise Storage OEM customers to provide
22 pre- and post-technical sales support for SSDs and other products and coordinated
23 internal engineering, manufacturing, testing and failure analysis to resolve product
24 design-in, customer qualification and field related issues. CW1 reported to Field
25 Applications Manager Robert Lopez. As detailed below, CW1 described first-hand
26 accounts of STEC shipping empty containers of products to customers in order to
27 report false revenue, and corroborated the information provided by other
28 confidential witnesses of the direct involvement and knowledge of the fraudulent

1 practices by Manouch and Mark Moshayedi, and of STEC's dependence on one
2 large customer.

3 (b) Confidential Witness 2 ("CW2") was STEC's Hewlett-Packard
4 ("HP") Inside Sales Representative in Santa Ana, California from June 2004
5 through July 2009 and, prior to that time, was a marketing specialist for STEC's
6 predecessor, SimpleTech, from June 2000 to June 2004. As detailed below, CW2
7 explained that Defendant Manouch Moshayedi was directly involved in ordering
8 STEC's sales force to pressure customers to move sales into third quarter 2009.
9 CW2 also described STEC shipping products with high failures rates in order to
10 meet sales.

11 (c) Confidential Witness 3 ("CW3") was a Quality Failure Analysis
12 Technician from November 2007 through November 2008, who worked on
13 products including Zeus. As detailed below, CW3 corroborated the information
14 provided by other confidential witnesses regarding the defectiveness and high
15 failure rates of STEC SSDs and detailed STEC's practice of lying to customers
16 about problems with the products.

17 (d) Confidential Witness 4 ("CW4") was a Regional Sales Manager
18 for the San Francisco Bay Area territory who worked for STEC from February
19 2006 through September 2009. As detailed below, CW4 corroborated that there
20 was a lot of "collaboration" between STEC and EMC, an early adopter of Zeus.

21 (e) Confidential Witness 5 ("CW5") was a Sales Coordinator for
22 STEC from late 2007 until July 2009, whose sales included Zeus products. As
23 detailed below, CW5 detailed the importance of EMC's business, including that
24 STEC management directed that EMC's orders were top priority and that they be
25 filled before orders from other customers.

26 (f) Confidential Witness 6 ("CW6") was a Technical Solutions
27 Architect with EMC from 1996 to mid-2009. As detailed below, CW6
28

1 corroborated the information provided by other confidential witnesses regarding
2 defective STEC SSD products and high failure rates with the Zeus drive.

3 (g) Confidential Witness 7 ("CW7") is a former HP Engineer who
4 worked for HP between August 2007 through May 2009. In that position at HP,
5 CW7 worked with SSDs from STEC. As detailed below, CW7 corroborated the
6 information provided by other confidential witnesses regarding the defective and
7 high failure rates of STEC SSDs.

8 (h) Confidential Witness 8 ("CW8") was a Sales and Field
9 Application Engineer for STEC in the San Francisco Bay Area and Pacific
10 Northwest from September 2008 through March 2009 whose work included the
11 Zeus SSD. CW8 reported to Field Applications Manager Robert Lopez. As
12 detailed below, CW8 corroborated the information provided by other confidential
13 witnesses that, among other things, Defendants Manouch and Mark Moshayedi
14 were directly and personally involved in all aspects of the business with EMC and
15 that STEC management had weekly sales meetings at which time they would talk
16 specifically about SSD revenue.

17 (i) Confidential Witness 9 ("CW9") was an Engineer for STEC in
18 Santa Ana, California from February 2005 through December 2008. As detailed
19 below, CW9 corroborated the information provided by other confidential witnesses
20 regarding the defective and high failure rates of STEC SSDs, and detailed STEC's
21 practice to ship untested product in order to recognize quarterly revenue on the
22 transaction.

23 (j) Confidential Witness 10 ("CW10") was a Test Engineer for
24 STEC for 13 years until July 2009. CW10 provided production test solutions for
25 STEC's flash products and SSD products. As detailed below, CW10 described
26 STEC's production and projections process, including that STEC based its
27 projections on purchase orders by customers such as EMC, and then purchased the
28 components to build the SSDs.

1 (k) Confidential Witness 11 ("CW11") was a Process Engineer for
2 STEC from December 2006 through July 2009, who worked on all of STEC's SSD
3 products. As detailed below, CW11 corroborated the information provided by
4 other confidential witnesses that Defendants Manouch and Mark Moshayedi were
5 directly and personally involved in all aspects of the business with EMC.

6 (l) Confidential Witness 12 ("CW12") was a Chief Technologist of
7 Storage and Data Management at Sun Microsystems from 1999 to April 2009, and
8 currently works for Pillar Data Systems as a Network Attached Storage
9 Technologist. CW12 worked with STEC SSDs. As detailed below, CW12
10 corroborated the information provided by other confidential witnesses regarding
11 the defective and high failure rates of STEC SSDs.

12 (m) Confidential Witness 13 ("CW13") was a Product Marketing
13 Specialist for STEC from June 2002 through October 2008, whose job included
14 marketing for the ZeusIOPS, among other products. As detailed below, CW13
15 corroborated the information provided by other confidential witnesses that
16 Defendants Manouch and Mark Moshayedi were directly and personally involved
17 in all aspects of the business with EMC.

18 V. THE FRAUDULENT CONDUCT

19 A. Background

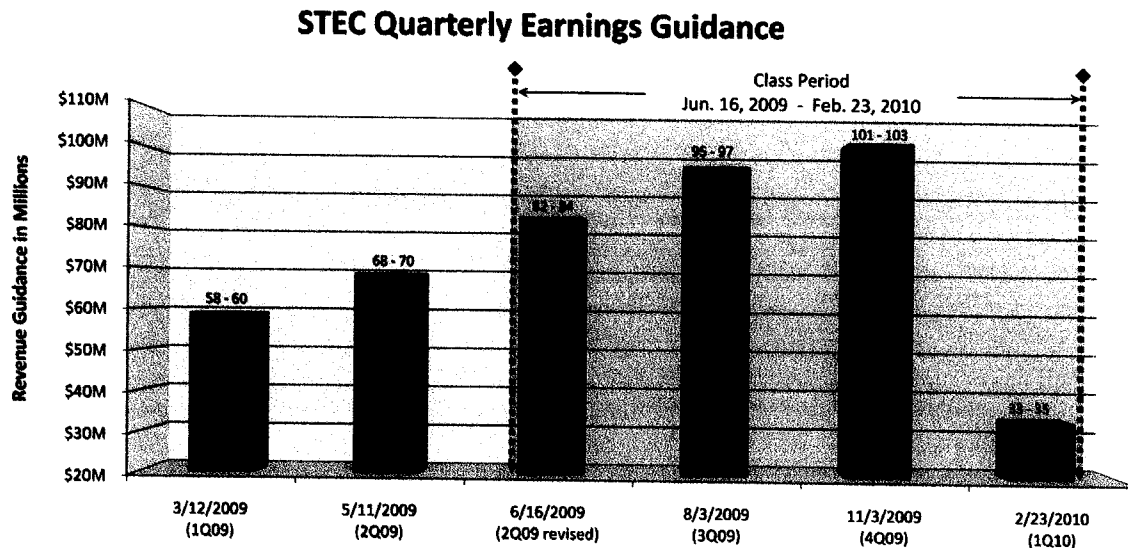
20 23. STEC purports to be a leading global provider of memory and storage
21 solutions tailored to meet the high-performance, high-reliability needs of OEMs
22 like Sun Microsystems, EMC, IBM, and Dell. During the Class Period, STEC's
23 core business was its enterprise scale SSDs, such as its flagship product, Zeus.

24 24. STEC, then named Simple Technology, Inc. ("SimpleTech"), was
25 founded in 1990 by Manouch Moshayedi and his brother, Masoud "Mike"
26 Moshayedi. At that time, they introduced a line of memory products for PCs,
27 notebooks, servers, printers and devices.
28

25. Throughout the 1990s, the Company grew rapidly, expanding its manufacturing facilities, acquiring a Flash controller design team from Cirrus Logic, establishing an OEM Sales Division, acquiring Kelly Microsystems and Silicon Tech, and opening European offices. In 1995, the Company was recognized on the Inc 500 list as one of the 50 fastest-growing businesses in the United States. The Company completed its initial public offering in September 2000, trading on the NASDAQ under the ticker symbol STEC.

26. As the Company continued to expand through acquisitions, in 2005, it introduced its high-end Zeus SSD product. Two years later, STEC introduced its flagship product, the ZeusIOPS SSD, with Enterprise grade storage systems.

27. During the Class Period, Defendants touted STEC as the only manufacturer of enterprise-scale SSDs, with promises of extraordinary revenue growth. As illustrated below, Defendants repeatedly announced increasingly higher earnings per share ("EPS") and revenue guidance as a result of its purported monopoly of the SSD market and, in particular, its flagship product, Zeus:



B. STEC Concealed Its Agreements With Its Largest Customer

28. Throughout its history, STEC heavily aligned itself with one large customer to purchase its SSDs. CW1 explained that STEC was a "one customer

1 dog” that would “get in bed” with one customer at a time. CW1 elaborated that
2 Cisco was STEC’s primary customer for SSDs in 2006, 2007, and 2008, until
3 Cisco “turned off their faucet, so to speak, and no longer was STEC’s ‘top dog.’”

4 29. Throughout the Class Period, STEC’s “top dog” was EMC. EMC was
5 STEC’s largest customer overall and its largest account in its core business of
6 SSDs, and, in particular, Zeus. CW5 reported that once EMC became STEC’s key
7 customer, STEC relied heavily on EMC to generate business through its
8 acceptance of STEC’s products. The focus on EMC was so great that CW5
9 reported that other, smaller customers were forced to wait increased lag time –
10 sometimes double that of EMC – for product orders.

11 30. As corroborated by several confidential witnesses, including CW8,
12 CW11, and CW13, Defendants Manouch and Mark Moshayedi were directly and
13 heavily involved in all aspects of the business with EMC, including, but not limited
14 to, working with the Company’s marketing efforts toward EMC and EMC’s
15 purchasing and selling of STEC’s products.

16 31. As STEC’s largest customer, EMC regularly communicated with the
17 Company, and, in particular, with Defendant Manouch Moshayedi, who was
18 heavily involved with the EMC account. For example, as explained by CW4, there
19 was a lot of “collaboration” between STEC and EMC. CW8 further confirmed that
20 STEC management had weekly sales meetings at which time they would talk
21 specifically about SSD revenue, and that Manouch and Mark Moshayedi would
22 have weekly conversations with EMC.

23 32. Further, as stated by an analyst during a November 3, 2009 analyst
24 conference call, STEC had “engineers co-located with EMC,” and thus STEC had
25 “good insight” into what amount of inventory was actually pulled off of EMC’s
26 shelf.

27 33. As admitted by Defendant Manouch Moshayedi, STEC’s customers,
28 including EMC, provided STEC with “*very solid forecasts*” in advance of STEC

1 agreeing to commit to supply the customer with products. (August 3, 2009
2 earnings call.)

3 34. Even before the truth about STEC's sales and demand began to be
4 revealed, STEC's relationship with EMC caught the attention of the SEC.
5 Following the unusually fast rise of STEC's stock price after announcements about
6 deals with EMC, and the massive insider selling by the Moshayedis, the SEC
7 questioned whether STEC had been forthcoming with investors, in particular with
8 respect to its dependence on EMC.

9 35. For example, the SEC inquired on August 28, 2009, why, despite the
10 fact that the Company depends on EMC for a significant portion of its revenue, the
11 Company has not disclosed any agreements with EMC. The Company responded
12 by letter dated September 10, 2009, that the EMC agreements are not ones upon
13 which the Company is substantially dependent. The SEC then followed up by
14 letter dated September 30, 2009, inquiring why the Company believed it is not
15 substantially dependent upon its agreements with EMC and another top customer,
16 and requested that STEC advise, in quantitative terms, whether sales to these
17 customers were based on a few large purchase orders or multiple small ones.
18 STEC responded by letter dated October 13, 2009, and continued to maintain that
19 the Company is not substantially dependent upon its agreements with EMC.

20 36. As a result of STEC's refusal to disclose STEC's agreements with its
21 largest customers, or even disclose the identity and percentage of revenue from
22 such customers, analysts and investors were forced to rely during the Class Period
23 on management's statements to gauge the strength of STEC's current and
24 forecasted sales and demand. In particular, analysts and investors focused on
25 management's increased revenue guidance and statements regarding demand for
26 Zeus, including stating, for example, "*We are adjusting our estimates to reflect the*
27 *improved guidance [from Zeus],*" (Thomas Weisel Partners, June 16, 2009); "*STEC*
28 *Announces Supply Contract [for Zeus], Improving Visibility: Reiterate Strong Buy,*

1 *Raising Target to \$40*" (Needham, July 16, 2009); and "*STEC reported solid*
2 *results and gave upbeat outlooks as the growth acceleration driven by the*
3 *enterprise-SSD ZeusIOPS segment continues to ramp.*" (Thomas Weisel Partners,
4 August 3, 2009).

5 C. Defendants' Fraudulent Practices

6 37. Defendants were only able to meet their increasing guidance through
7 fraudulent practices. Numerous confidential witnesses have confirmed that
8 STEC's standard practice was to force sales so that revenue could be immediately
9 recorded. As detailed below, Defendants did so by, among other things: (i)
10 "shipping bricks"; (ii) sending defective or untested products; (iii) lying to
11 customers and altering error reports; and (iv) announcing an extraordinary deal
12 with EMC which purported to represent continued growth and demand. In
13 addition, as detailed in Section VIII below, Defendants engaged in accounting
14 manipulations with respect to the EMC contract in order to improperly record
15 revenue.

16 38. As detailed below, the Company's top officers, Manouch and Mark
17 Moshayedi, themselves were directly involved in these fraudulent practices.
18 Defendant Manouch Moshayedi ordered the practices because Defendants wanted
19 the quarterly revenue numbers to "look grand," and Defendant Mark Moshayedi
20 declared such practices were Defendants' "business decision."

21 1. Defendants Knowingly Shipped Empty
22 Containers And Defective Product

23 39. Numerous confidential witnesses corroborate that STEC frequently
24 and knowingly shipped empty containers and defective and untested products in
25 order to report false quarterly revenue and boost STEC's stock price.

26 40. For example, CW1 stated that STEC would regularly engage in
27 "*shipping bricks*." CW1's supervisor explained that "shipping bricks" is the
28 process of shipping boxes – which, unbeknownst to the recipient, were empty or

1 contained the wrong product – just before the quarter ends, allowing STEC to
2 receive a Federal Express notification that purported inventory had been shipped so
3 that STEC could record it on the books for that quarter. It then would take a few
4 days before the customer realized that the package did not contain the product it
5 ordered, at which time the customer would call STEC sales people, including
6 CW1, to complain. When CW1 directly questioned his supervisor about this
7 recurring problem, CW1’s supervisor explained what “shipping bricks” was and
8 stated that STEC had been “shipping bricks” “for years.”

9 41. CW9 further noted that, at the end of each quarter, STEC would ship
10 products that had not been tested in order to recognize revenue on the transaction.
11 For example, CW9 detailed that, in the fourth quarter of 2008, STEC’s Vice
12 President of Operations shipped product that was not even working – to someone
13 other than the customer – in order to include the shipment of products as a “sale.”
14 CW9 reported that this type of attempt to move sales into a quarter was “some sort
15 of tradition” at STEC, and that this particular transaction was for “huge money.”

16 2. Defendants Lied To Customers
17 About STEC’s Product Quality And Altered
18 Reports To Improperly Record Revenue

19 42. With respect to Zeus in particular, CW6 explained that this core
20 product had an “unusually high failure rate.” Several confidential witnesses,
21 including CW7, CW3, CW12, and CW9, corroborated that the unusually high
22 failure rate for STEC SSDs was a result of, for example, the drive burning out,
23 bugs, software issues, hardware wear leveling, the small computer systems
24 interface, thermal problems, and poor coding.

25 43. Numerous confidential witnesses reported that Defendants, having
26 knowingly manufactured defective products, falsified fail rate numbers for SSDs
27 (and Zeus in particular) and withheld other relevant information from STEC’s
28 customers.

1 44. For example, CW9 detailed how STEC “cheated a lot of customers.”
2 Specifically regarding Zeus, CW9 confirmed that it performed poorly and the
3 quality of the product was poor. STEC nevertheless promised customers a certain
4 level of performance, but hid information about the integrity of the product. CW9
5 explained that tests showed that the product did not meet the performance level
6 STEC purported to sell, but STEC continued to falsely represent that it met certain
7 performance standards. Further, with respect to Zeus specifically, CW9 reported
8 that STEC’s biggest customer, EMC, was “asking a lot of questions” because Zeus
9 was not meeting basic customer expectations. According to CW9, EMC also
10 returned thousands of Zeus products because of errors, the inability to keep up with
11 the systems, and the product continuously failing.

12 45. CW3 also confirmed that STEC’s practice was to lie to customers.
13 Many times after an analysis of a product’s problem was performed, “it would be
14 decided to not tell the customer.” CW3 provided the following example: STEC
15 experienced a “black pad issue” during the time he was with the Company.
16 According to CW3, this is a very serious problem that affects memory and flash
17 products. He described the problem as a “process issue” which is caused during
18 the chemical cleaning process. A black film forming prevents solder from adhering
19 to the pad and, over time, the pad opens up and the connectivity between the
20 memory chip and the pad is broken. The result is that the memory or flash
21 becomes unreliable. CW3 found that this problem occurred in many cases and
22 even wrote reports documenting the problem. STEC management, however,
23 ***altered the reports*** because it did not want the customer to know the truth about the
24 problems. As described by CW3, STEC management went as far as doctoring
25 reports with pictures from another case.

26 46. CW10 confirmed that when CW10 was assisting STEC’s quality
27 department, failed devices were given to CW10 to test and determine the failure
28 mode. CW10 would relay the information to STEC’s quality group and the quality

1 group would say: "We can't tell the customer that; we have to say something
2 different." As confirmed by CW10, the pressure to lie to customers came directly
3 from Defendants Manouch and Mark Moshayedi.

4 47. CW1 corroborates that STEC management expressly told STEC
5 employees to lie, explaining that in one particular situation involving sales to
6 Cisco, CW1 received emails and directives from STEC management, directors and
7 STEC's quality assurance representatives, ordering as follows: ***"Don't tell them
8 we have these many failures. Tell them whatever you want [but don't tell them
9 the truth]."***

10 48. CW10 explained that STEC's corporate policy of lying to customers
11 about STEC's products was said by Defendants to be their "business decision."
12 For example, CW10 experienced quality concerns with STEC's industry-grade
13 Flash products. Those Flash products that were bought by customers for industrial
14 use were required to go through a screening process that involved testing at
15 extreme temperatures and a guarantee that the product would work under those
16 extreme conditions. The products that would pass would be sold as industrial
17 grade and those that did not would be sold as commercial grade. STEC
18 disseminated information to customers through specification sheets that extreme
19 temperature testing was done 100 percent of the time when, in truth, STEC had
20 stopped doing the extreme temperature testing. CW10 brought this wrongful
21 practice to the direct attention of Defendant Mark Moshayedi towards the end of
22 2008. In response Mark Moshayedi said, ***"It's a business decision and that's what
23 we're going to do."*** As a result of Defendant Mark Moshayedi's response, CW10
24 then spoke with Dan Moses (STEC's CFO until November 2008), who at the time
25 was on the Ethics Committee. Dan Moses responded that he would speak to Mark
26 Moshayedi about the issue.

27 49. CW1 also corroborated that Defendant Mark Moshayedi was directly
28 involved and had actual knowledge of the failures with Zeus. CW1 explained that

1 STEC led at least one of its customers, Sun Microsystems, to believe that Zeus was
2 programmed to check the battery voltage of the super capacitors once or twice per
3 day, which was important to Sun Microsystems because it used Zeus in
4 applications that ran twenty-four hours per day. In truth, STEC's super capacitors
5 in Zeus were notorious for going bad. CW1 learned through two independent
6 sources (an STEC failure analysis engineer who dealt directly with Sun
7 Microsystems, and an STEC sales person who dealt directly with Sun
8 Microsystems) that in 2009 while Defendant Mark Moshayedi was having lunch
9 with Sun Microsystems representatives, a conversation took place specifically
10 regarding the monitoring of the super capacitors in Zeus. During the conversation,
11 Mark Moshayedi revealed for the first time to Sun Microsystems that Zeus would
12 check the super capacitors only when the units were actually powered on, not
13 automatically throughout the day as previously represented by STEC to Sun. This
14 reportedly caused a huge blowup between Mark Moshayedi and Sun, which
15 resulted in Sun Microsystems cancelling all orders with STEC. Sun Microsystems
16 expressly told Defendant Mark Moshayedi that Sun Microsystems would no longer
17 accept STEC SSDs because they were not what Sun Microsystems believed it had
18 purchased.

19 50. By way of further example, CW2 described an incident in February
20 2009 wherein STEC falsified fail rate numbers on a shipment to its customer HP.
21 STEC shipped an order to HP of DRAM modules, STEC part #hpqd2-1gd00-667-
22 eba, HP part #405476-051, in late 2008 or early 2009. A certain percentage of the
23 units failed and HP shipped the entire order back to STEC for retesting and put
24 STEC on "worldwide stop ship." The retesting process took two weeks and
25 revealed that 45 units out of the 402 failed. However, STEC, under the direction of
26 STEC's Vice President of Sales, informed HP that only 2 units of the 402 had
27 failed under retesting. Despite the "stop ship" order, STEC replaced the 45 failed
28 units and shipped them back to HP. When CW2 inquired by e-mail, copying

1 numerous STEC employees regarding why HP was not being told the truth about
2 the failed units, CW2 was told not to “broadcast” this type of information by
3 e-mail. CW2 later received an e-mail from an HP employee confirming that the
4 original 402 modules had “failed miserably” and should not have been shipped
5 back to HP as STEC had been put on stop ship at that point.

6 51. Defendant Manouch Moshayedi was directly involved in ordering
7 STEC’s sales force to move sales into third quarter 2009 – the same quarter in
8 which Defendants Manouch and Mark Moshayedi unloaded 9 million shares at a
9 near all-time high price. For example, CW2 explains that Manouch Moshayedi
10 directly told STEC’s Vice President of Sales to pull all of Cisco’s sales from the
11 fourth quarter 2009 into third quarter 2009 to make the third quarter sales look
12 better. As discussed at one weekly Monday meeting, Defendant Manouch
13 Moshayedi told the Vice President of Sales: “You go to Cisco and tell them they
14 have to take everything this quarter.” As explained by CW2, if Manouch
15 Moshayedi needed the sales, he would pull the sales to that quarter. Defendant
16 Manouch Moshayedi gave this instruction because he wanted the third quarter
17 2009 revenue numbers to “*look grand.*”

18 D. Defendants Increase Guidance,
19 Citing Purportedly Successful Zeus Sales

20 52. Also in the third quarter 2009, the same quarter in which Defendant
21 Manouch Moshayedi ordered that sales be accelerated so that STEC’s revenue
22 would “look grand,” STEC announced a \$120 million deal with its largest
23 customer, EMC. The artificial inflation of stock price associated with the
24 incomplete and misleading announcement of this deal allowed Defendants
25 Manouch and Mark Moshayedi to dump 9 million shares of their personally held
26 STEC stock in a rushed secondary offering at a near all-time high price.

27 53. Although Defendants claimed that the \$120 million deal would cover
28 EMC’s product needs for the third and fourth quarters of 2009, Defendants knew

1 or deliberately disregarded that the contract would oversupply EMC and meet its
2 inventory needs well into 2010.

3 54. Before the open of the stock market on June 16, 2009 (the beginning
4 of the Class Period), STEC issued a press release announcing increased earnings
5 and revenue guidance for second quarter 2009. As detailed further below, the press
6 release explained that the increased earnings and revenue are “*primarily the result*
7 *of increases in the Company’s Zeus IOPS sales which now are estimated to*
8 *exceed \$55 million during the second quarter of 2009.*”

9 55. On STEC’s announcement, the price of STEC stock increased 27% in
10 a single day to close at \$22.88 per share on June 16, 2009, a \$4.86 increase from
11 the prior day’s closing price of \$18.02, on extraordinarily high trading volume of
12 10.4 million shares. At the time, STEC’s stock price represented an all-time high.

13 56. Just one month later, on July 16, 2009, STEC issued another press
14 release announcing an agreement with its largest customer, EMC, to purchase \$120
15 million of Zeus in the second half of 2009, resulting in an increase in the
16 Company’s forecast for Zeus sales to more than \$220 million in the second half of
17 2009. In the press release STEC represented that “this agreement reflects [EMC’s]
18 continued commitment to integrate STEC’s SSD technology”

19 57. Following STEC’s announcement, the price of STEC stock rose
20 another 15.2%, or \$4.20 per share in a single day, over the previous day’s closing
21 price to close at \$31.79 per share on July 16, 2009, on extraordinarily high trading
22 volume. STEC’s stock price thus reached another all-time high.

23 58. In the following weeks, the price of STEC stock continued to climb.
24 On August 3, 2009, the price of STEC stock closed at yet another new all-time
25 high of \$35.50 per share. After the market closed that day, STEC issued a press
26 release announcing the Company’s financial results for the second quarter of 2009.
27 Defendants highlighted the reported revenue growth from Zeus. As detailed below
28

1 in Section VIII, such reported revenue growth was only obtained through
2 accounting manipulations and GAAP violations.

3 59. Also on August 3, 2009, Defendant Manouch Moshayedi assured the
4 market of continued growth from Zeus, emphasizing that the \$120 million
5 agreement with EMC "*is a further indication of future SSD growth and*
6 *customers' acceptance of SSDs into this growing market,*" and that the chances of
7 emerging competition was "*zero.*"

8 E. After Artificially Inflating The Price Of
9 STEC Stock, Defendants Manouch And Mark
10 Moshayedi Engaged In Massive Insider Selling

11 60. After falsely fueling an extraordinary rise in the price of STEC stock
12 from \$4 per share in December 2008 to \$35.50 per share on August 3, 2009 – an
13 increase of over 850% – Defendants Manouch and Mark Moshayedi timely
14 unloaded 9 million of their own STEC shares. Specifically, on August 3, 2009,
15 Defendants announced that they would conduct a "Secondary Offering" of at least
16 7.5 million shares, all for the personal profit of Defendants Manouch and Mark
17 Moshayedi, with no proceeds going to the Company.

18 61. With this announcement, Defendants also announced that Defendants
19 Manouch and Mark Moshayedi *had cancelled their 10b5-1 trading plans which*
20 *they had adopted just two months earlier.* The 10b5-1 trading plan program
21 enables insiders to set predetermined contractual sales of stock in advance
22 regardless of the knowledge of material information. Here, because the insiders
23 (Defendants Manouch and Mark Moshayedi) urgently wanted to take advantage of
24 the newly inflated stock price before the truth was revealed, they promptly
25 cancelled their new 10b-5 plans and quickly unloaded their stock in massive
26 quantities in an offering.

27 62. Just three days after announcing the secondary offering, STEC
28 announced on August 6, 2009, the price of the price of the offering, \$31 per share.

1 STEC also announced that the amount of the secondary offering would be raised to
2 9 million shares.

3 63. Manouch and Mark Moshayedi sold their 9 million shares of STEC
4 stock in the secondary offering on August 11, 2009, *reaping \$267.8 million in a*
5 *single day*. These sales dramatically reduced the Moshayedis' insider holdings in
6 STEC. On that day, the Moshayedis went from collectively owning 35.5% of the
7 Company's stock, down to owning just 17.4%. Defendant Manouch Moshayedi
8 reduced his STEC holdings from 14.8% of the Company to 6.5% and Defendant
9 Mark Moshayedi reduced his STEC holdings from 20.7% to 10.9%. This was by
10 far the historically largest sale of their personally held STEC stock.

11 64. This sale was in addition to the more than \$25 million in shares that
12 Manouch and Mark Moshayedi's third brother and STEC co-founder, Masoud
13 ("Mike") Moshayedi, had sold in June and July, beginning the day after STEC's
14 June 16, 2009 announcement. According to Mike Moshayedi's Form 4s, he sold
15 over one million shares at that time.

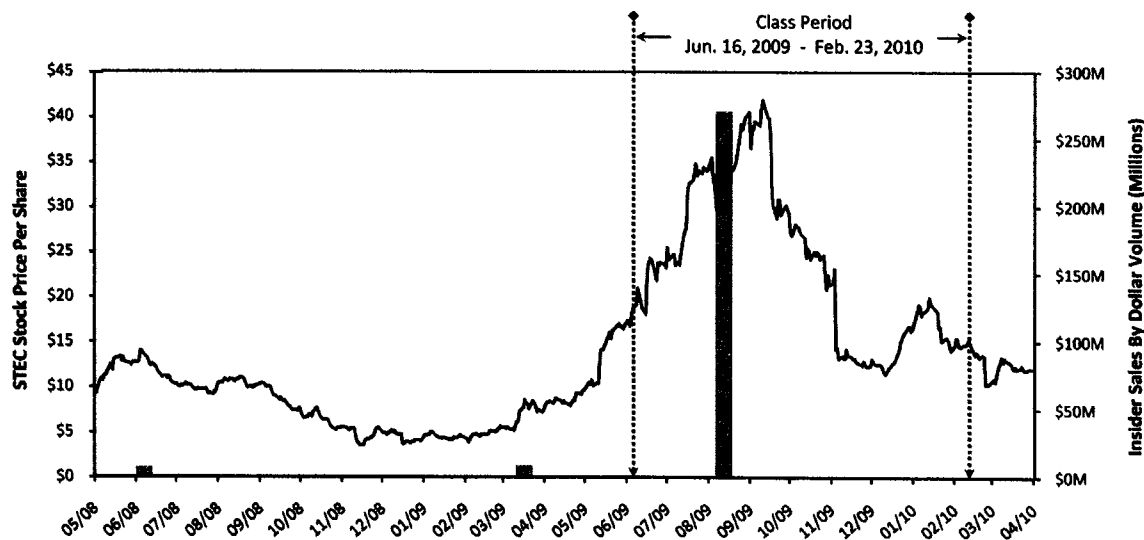
16 65. Conveniently for Defendants, as the full truth was later revealed in
17 STEC's February 23, 2010 Form 10-K and the Company stock plummeted, STEC
18 reported that its board of directors had authorized a stock repurchase program
19 effective November 10, 2009 – just three months after Defendants Mark and
20 Manouch Moshayedi's massive secondary offering. This repurchase program
21 allows STEC to repurchase up to \$75 million of its shares at their now devastated
22 price.

23 66. A commentator at Seeking Alpha later explained the suspicious and
24 unusual trading preceding the eventual announcement that the EMC deal was only
25 a one time deal, as follows: *"Whether management knew about the*
26 *demand/inventory issue in advance or not, the market found it too coincidental*
27 *that top management made such a substantial sale of stock in the very quarter*
28 *they blew up."*

67. Following STEC's November 3 announcement, the SEC instituted a formal investigation into insider trading at STEC. The Company's February 23, 2010 Form 10-K announced for the first time: "The [SEC] is conducting a formal investigation involving trading in our securities. Certain of our officers and employees, including our CEO and President, have received subpoenas in connection with the SEC's investigation."

68. Indeed, the Moshayedis were remarkably successful in timing their offering, selling at a near all-time high of \$31 per share. There are only two months in the Company's entire history in which its stock price traded higher, just before the truth began to be revealed.

69. In the prior calendar year, 2008, Defendant Manouch Moshayedi did not sell *any* stock, and sold only 400,000 shares in March 2009 for proceeds of \$3 million. Defendant Mark Moshayedi sold only 466,292 shares in June 2008 and another 400,000 shares in March 2009, for proceeds of \$6.5 million and \$3 million, respectively. The number of shares sold by the Moshayedis in the August 2009 secondary offering were collectively more than **11 times** the number of shares they sold in the six months before the Class Period and nearly **20 times** the number of shares they sold in all of 2008. Thus, as demonstrated in the chart below, the Moshayedis' trading was highly suspicious in volume and timing:



1 70. In sum, the Moshayedis' Class Period stock sell-off was the biggest
2 insider stock liquidation in the history of STEC.

3 71. This, however, was not the first time that the Moshayedis were, as
4 one commentator characterized it, "spot-on" for the timing of an extraordinary
5 offering of their own personal shares. For example, on October 1, 2003, STEC
6 (then-called SimpleTech, with Manouch Moshayedi serving as the CEO, Mark
7 Moshayedi serving as the COO and CTO, and their brother, Masoud Moshayedi,
8 serving as the President) announced the Company's third quarter 2003 guidance as
9 a result of a purported increased demand for the Company's products. The
10 Company raised revenue guidance to \$57 to \$58, from the earlier guidance of \$48
11 to \$50, and raised the EPS to \$0.01 from its previous guidance of \$-0.01.

12 72. The very same day, the Company announced a secondary offering of
13 10 million shares, including 2.5 million shares personally held by the three
14 Moshayedi brothers and other insiders. The Company disclosed that the proposed
15 offering would allow the three Moshayedi brothers to go from 78.6% ownership to
16 51.5% ownership. When they made the announcement, STEC shares were near
17 their then all-time high. As with Defendants Manouch and Mark Moshayedi's
18 most recent offering of their own personal STEC shares, within just months after
19 the Moshayedis cashed in their shares of STEC at inflated prices, the stock price
20 plummeted back to what its price had been before the Moshayedis increased
21 guidance. Not surprisingly, the stock price chart for that 2003 time period looks
22 nearly identical to the stock price chart related to the Moshayedis' most recent sell-
23 off.

24 F. The Aftermath

25 73. As detailed below, only after the three Moshayedi brothers reaped the
26 benefits of the artificially inflated stock price by selling their stock at
27 unprecedented high prices, did the truth about STEC's business and operations
28 begin to be revealed. The Company eventually admitted that, contrary to

1 Defendants' prior representations that the \$120 million EMC deal was indicative of
2 future Zeus revenue growth, it was merely a one-time deal for excess inventory
3 with a single customer, and there were no prospects for a future commitment from
4 EMC.

5 74. EMC, itself, later openly stated to analysts that the order to STEC
6 intentionally included excess inventory, not just for 2009, but also into 2010. For
7 example, EMC explained during its January 26, 2010 earnings conference call that
8 "[w]e have good relationships with all of our suppliers," and the order with STEC
9 for excess inventory "was designed to protect ourselves going into first quarter
10 against what we knew would be a tight supply environment."

11 75. STEC's stock price currently trades at \$11.76, below the stock price at
12 the beginning of the Class Period, and 72% below the Class Period high just seven
13 months ago. The 9 million shares that Defendants Manouch and Mark Moshayed
14 unloaded to shareholders in the market at \$31 per share are now worth only one-
15 third of that.

16 VI. DEFENDANTS' FALSE AND MISLEADING STATEMENTS

17 76. As set forth below, Defendants made repeated materially false and
18 misleading statements to investors and the market throughout the Class Period
19 regarding STEC's revenues, demand, and competition. Specifically, Defendants
20 made false and misleading statements and omissions regarding: (i) STEC's
21 revenues from Zeus; (ii) the \$120 million supply agreement with EMC; (iii)
22 STEC's customer base and future growth; (iv) STEC's product quality; (v) STEC's
23 competition; and (vi) STEC's internal controls and compliance with GAAP and
24 SEC regulations.

25 A. STEC's Revenues From Zeus

26 77. Before the open of the stock market on June 16, 2009, the first day of
27 the Class Period, STEC issued a press release entitled "STEC Increases Its
28 Guidance for the Second Quarter of 2009." The release highlighted the purported

1 increase in demand for the Company's ZeusIOPS SSD. Specifically, the release
2 stated, in part:

3 The Company expects to report Non-GAAP diluted earnings per share
4 in the range of \$0.32 to \$0.36, versus the previous guidance of \$0.20
5 to \$0.22 per diluted share announced on May 11, 2009.

6 *The Company also expects to report revenue in the range of \$82*
7 *million to \$84 million, versus the previous estimate of \$68 million to*
8 *\$70 million.*

9 The increased Non-GAAP diluted earnings per share and revenue
10 guidance are *primarily the result of increases in the Company's*
11 *ZeusIOPS sales* which are now estimated to exceed \$55 million
12 during the second quarter of 2009.

13 The Company previously estimated revenue from ZeusIOPS SSDs to
14 surpass \$65 million during the first half of 2009. With this increase in
15 revenue, the Company now expects ZeusIOPS SSD sales to exceed
16 \$80 million during the first half of 2009.¹

17 78. Defendants' June 16, 2009 statements had a direct effect on STEC's
18 stock price, which immediately increased more than 27%, to \$22.80 per share on
19 unusually high trading volume.

20 79. Thereafter, on August 3, 2009, STEC issued a press release
21 announcing final results for the second quarter of 2009, entitled "Revenue, Gross
22 Profit Margin and EPS Higher On Faster-Than-Expected Adoption of Its Enterprise
23 Class Solid State Drives." This release stated, in part, as follows:

24 Revenue for the second quarter of 2009 was \$86.4 million, an increase
25 of 53.7% from \$56.2 million for the second quarter of 2008, and an
26 increase of 35.9% from \$63.5 million for the first quarter of 2009.

27
28 ¹ Unless otherwise noted, all emphasis is added.

1 Shipments of our ZeusIOPS Solid-State drives ("SSD") into the
2 Enterprise-Storage market grew to \$57.7 million for the second
3 quarter of 2009, an increase of approximately 375% from \$12.1
4 million for the second quarter of 2008, and an increase of
5 approximately 125% from \$25.7 million for the first quarter of 2009.

6
7 GAAP gross profit margin was 50.0% for the second quarter of 2009,
8 compared to 32.3% for the second quarter of 2008 and 36.3% for the
9 first quarter of 2009. GAAP diluted earnings per share from
10 continuing operations was \$0.38 for the second quarter of 2009,
11 compared to \$0.03 for the second quarter of 2008, and \$0.07 for the
12 first quarter of 2009.

13 80. The press release also provided the following guidance to analysts and
14 investors: "[w]e currently expect third quarter of 2009 revenue to range from \$95
15 million to \$97 million with diluted non-GAAP earnings per share to range from
16 \$0.45 to \$0.47."

17 81. The foregoing statements regarding increased second quarter revenue
18 and second and third quarter guidance were materially false and misleading when
19 made because Defendants knew or deliberately disregarded, but failed disclose,
20 *inter alia*, that:

- 21 (a) STEC was "shipping bricks," allowing it to record sales for
22 goods that had not actually been shipped;
- 23 (b) STEC's sales could not be sustained because some of the
24 Company's customers, including IBM and Sun Microsystems,
25 were having significant difficulties integrating STEC's products
26 such that the Zeus was not being adopted by these important
27 OEMs;
- 28

- 1 (c) STEC pressured customers to accept orders before the quarter's
2 end, regardless of the customers' need for that product at that
3 time;
- 4 (d) STEC reported revenues for products that were often rushed out
5 prematurely without sufficient testing, and were later found to
6 be faulty, causing frequent returns; and
- 7 (e) STEC's revenues were based on products that were being
8 shipped and paid for as new, despite having refurbished or
9 damaged parts.

10 82. The August 3, 2009 release quoted Defendant Manouch Moshayedi,
11 in part, as follows:

12 "It is exciting to share such outstanding results today and to deliver
13 significant revenue, gross profit margin and EPS growth for the
14 second quarter of 2009," said Manouch Moshayedi, STEC's
15 Chairman and Chief Executive Officer. *"We have shown a*
16 *significant improvement in our already strong balance sheet –*
17 *particularly in the generation of cash and effective management of*
18 *inventory – added four more major Enterprise-Storage OEMs to our*
19 *blue chip customer list*, and surpassed our stated year-end 2009 non-
20 GAAP gross profit margin goal of 40%, expanding it to 50% in the
21 second quarter of 2009."

22 83. These statements were materially false and misleading when made
23 because Defendant Manouch Moshayedi knew or deliberately disregarded that the
24 "generation of cash" and purported "effective management of inventory" were a
25 result of STEC oversupplying customers, "shipping bricks," and accelerating sales
26 to show increased revenue by quarter's end.

27
28

1 84. Further, Defendants failed to disclose that it did not have the ability to
2 develop quality products for or integrate its products with the four new “major
3 Enterprise-Storage OEMs.”

4 B. The \$120 Million Supply Agreement For Zeus

5 85. On July 16, 2009, STEC issued a press release entitled “STEC Signs a
6 \$120 Million Supply Agreement for ZeusIOPS SSDs for 2H 2009 and Now
7 Forecasts Sales of ZeusIOPS SSDs to Exceed \$220 Million in 2009 – STEC and
8 Its Major Enterprise Storage Customers Continue Collaboration to Drive Adoption
9 of SSD Technology Into High-Performance Enterprise Storage Systems,” which
10 stated, in part:

11 STEC, Inc. (Nasdaq: STEC), announced today that it has signed an
12 agreement with one of its largest enterprise storage customers for
13 sales of \$120 million of ZeusIOPS SSDs in the second half of 2009.
14 *STEC believes that this agreement reflects the enterprise storage*
15 *manufacturer’s continued commitment to integrate STEC’s SSD*
16 *technology into the manufacturer’s systems and validates significant*
17 *storage system performance improvements enabled by STEC’s*
18 *ZeusIOPS SSDs in these enterprise systems. With this agreement*
19 *signed, STEC now forecasts revenue from the sale of its ZeusIOPS*
20 *drives will exceed \$220 million in 2009.*

21 86. Further, the Company’s August 3, 2009 press release emphasized the
22 \$120 million contract as a “highlight[] for the second quarter of 2009”: “[STEC]
23 signed a recently-announced \$120 million contract to supply ZeusIOPS SSDs to a
24 major Enterprise-Storage customer for the second half of 2009.”

25 87. Each of these statements regarding STEC’s \$120 million supply
26 agreement for Zeus was materially false and misleading because, as detailed
27 herein, Defendants knew or deliberately disregarded, but failed to disclose, that:
28

- 1 (a) Such significant shipments would over-supply EMC – STEC’s
2 largest customer accounting for more than 90% of its Zeus sales
3 – with several quarters’ worth of excess inventory;
- 4 (b) This increased revenue could not continue because EMC
5 intended this \$120 million order to cover its inventory needs
6 until at least the middle of 2010, such that STEC’s revenue
7 would decline dramatically if it did not find additional large
8 customers for the first half of 2010. As EMC stated in its
9 January 26, 2010 earnings conference call, its \$120 million
10 build up of inventory in the fourth quarter “was designed to
11 protect” EMC going into 2010 against a “tight supply
12 environment.” A February 23, 2010 Thomas Weisel Partners’
13 report also noted that “EMC has *repeatedly indicated* that the
14 SSD inventory build-up reflected a management choice to
15 protect EMC against potential tightness of supply in 1H10”;
- 16 (c) The agreement did not validate significant storage system
17 performance improvements because STEC supplied EMC with
18 faulty products with high rates of failure; and
- 19 (d) STEC’s major commitment to EMC and other large customers
20 meant that smaller customers suffered and were forced to wait
21 double the lead time for products.

22 C. STEC’s Customer Base And Growth

23 88. The July 16, 2009 release also quoted Defendant Manouch Moshayedi
24 as follows:

25 “We are pleased to see that sales of our customer’s enterprise storage
26 systems utilizing our ZeusIOPS drives have grown significantly over
27 the past few years,” said Manouch Moshayedi, Chairman and Chief
28 Executive Officer of STEC. “*Our customers have helped evangelize*

1 *this technology and we are glad to be partnered with them as we*
2 *expect that they will help drive further innovation in SSD usage in*
3 *the highest-end of the enterprise storage markets.”*

4 89. Defendant Manouch Moshayedi’s foregoing statement was materially
5 false and misleading because Defendants knew or deliberately disregarded that the
6 expectation that STEC’s customers would “help drive further innovation in SSD
7 usage” was unrealistic because STEC was shipping “bricks” and faulty products to
8 its customers. Defendants’ statements regarding STEC’s customers’ help in
9 “evangeliz[ing] this technology” omitted the truth that STEC’s customers were
10 having difficulty integrating its products and were frequently returning products as
11 a result of failures. Undisclosed to investors, STEC was lying to customers about
12 failure rates and the steps the Company was taking to fix products and remedy
13 customers’ concerns. In fact, other major OEM’s chose not to adopt STEC’s
14 products because they heard of the high failure rates.

15 90. STEC’s August 3, 2009 press release also stated, in part:

16 In our prior quarter’s earnings announcement we had estimated that
17 ZeusIOPS revenue for the first half of 2009 would surpass \$53
18 million. I am pleased to report that we have actually achieved \$83
19 million in ZeusIOPS revenue for this period. Although we are still
20 early in the process of the adoption of SSDs into the Enterprise-
21 Storage market, I believe that the \$120 million supply agreement that
22 we signed for the second half of 2009 is a *further indication of the*
23 *future SSD growth and customers’ acceptance* of SSDs into this
24 growing market. I am very excited about our product road map –
25 specific to the Enterprise-Storage, Enterprise-Server and related
26 markets.

27 91. Also on August 3, 2009, Defendants filed STEC’s quarterly report
28 with the SEC on Form 10-Q for the second quarter 2009 (“2Q09 Form 10-Q”).

1 Defendants Manouch Moshayedi and Cook signed the Company's 2Q09 Form
2 10Q, affirming the financial results and stating, in part:

3 *We expect continued growth in the sales of our Flash-based SSD*
4 *ZeusIOPS products through 2009 based on the accelerated adoption*
5 *of our ZeusIOPS SSDs by most of our major enterprise-storage and*
6 *enterprise-server OEM customers into their systems.* As part of this
7 expected growth, on July 16, 2009 we announced an agreement with
8 one of our largest enterprise storage customers for sales of \$120
9 million of ZeusIOPS SSDs in the second half of 2009.

10 92. Defendants' statements in the August 3, 2009 press release and
11 STEC's 2Q09 Form 10-Q were materially false and misleading when made. The
12 statements that the \$120 million supply agreement "is a further indication of the
13 future SSD growth and customers' acceptance of SSDs into this growing market"
14 and touting "accelerated adoption" failed to disclose that customer "acceptance"
15 and "continued growth" would *not* continue once customers realized the poor
16 product quality they were receiving from STEC. Further, Defendants knew or
17 deliberately disregarded that the EMC deal was a "one-off" (*i.e.*, one time) deal
18 that would supply EMC for several months, was not an "indication of future SSD
19 growth," and, in accordance with GAAP, the EMC deal could not be recognized in
20 full during 2009.

21 93. The same day, August 3, 2009, Defendants hosted a conference call
22 with analysts and investors to discuss STEC's second quarter 2009 financial results
23 and guidance. Defendants Manouch Moshayedi and Cook participated in the call.
24 On that call, Defendants stated, in part:

25 [ANALYST:] If I'm looking at the math right, with the 39% of
26 revenue that you got from your largest customer, be it maybe EMC,
27 we'll assume, and what you're guiding, I guess still reiterating the 220
28 in terms of Zeus revenue for the full year, it seems to me that you're –

1 are you being relatively pretty conservative with regard to the ramp to
2 the other customer opportunities, which I think last quarter you said
3 would reach into full production in Q3?

4 [MANOUCH MOSHAYEDI:] *Yes, so I think other customers are*
5 *taking a little bit longer than expected in terms of full production.*

6 They're introducing the systems into the market. *It looks like*
7 *everybody is going through the same trials and tribulations that our*
8 *first customer went through in terms of sales and marketing side.*

9 So, it's still a, I would say, maybe a quarter or two away from full
10 ramping production.

11 * * *

12 [ANALYST:] Quick question on EMC, your largest customer. They
13 made a comment about, on their earnings call about shipping close to
14 a petabyte [or] actually over a petabyte of Flash related storage year to
15 date. And that conference call took place three weeks into the month
16 of July. Obviously there's been a fairly steep ramp, particularly in
17 light of, if we're guessing correctly, to that large supply contract you
18 signed for second half of the year involved, but how much of – if
19 we're thinking about that petabyte shift, was July a fairly big month
20 for you guys in terms of shipments so far? Just want to get my hands
21 around the steepness of the ramp going into the second half of the
22 year.

23 [MANOUCH MOSHAYEDI:] [W]e think that ZeusIOPS sales from
24 Q to Q is going to go up about \$10 million from Q2 to Q3. *So the*
25 *ramp right now about 20% rate on a quarterly basis.* That's
26 basically based on one customer in production, *four customers are*
27 *still in pre production type of stage.* So I think we will start seeing a
28 ramp on a few things. One of our customers is in the middle of

1 discussions in terms of M&A discussions. I think once that gets
2 resolved, the customer will kick back in and start buying at its original
3 rate. *The other three customers are very large, and it takes them a*
4 *little longer to get all the parts right. So I think once they start*
5 *kicking in, we will see huge ramps in sales of ZeusIOPS going*
6 *forward.* I don't know if it's going to be next quarter, the quarter
7 after, but it will come sooner or later.

8 94. Defendants' statements that STEC's new customers were "going
9 through the same trials and tribulations that our first customer went through in
10 terms of sales and marketing side" and that these customers were "very large, and
11 it takes them a little longer to get the parts right" were materially false and
12 misleading when made because Defendants knew or deliberately disregarded that
13 these customers were actually facing significant problems integrating STEC's
14 products. In particular, Defendants knew or deliberately disregarded, but failed to
15 disclose that:

- 16 (a) STEC promised customers features that the products lacked,
17 and that could not be added without the Company taking a
18 complete loss on its existing version of the product;
- 19 (b) STEC pressured its major customers to design their products to
20 suit STEC's offerings, rather than tailoring its products to suit
21 its customers' needs;
- 22 (c) Prior customers, including Sun Microsystems, refused to
23 continue to do SSD business with STEC due to a lack of
24 product quality; and
- 25 (d) Similar product quality issues and STEC's misrepresentations
26 regarding failure rates and reasons for failure strained STEC's
27 relationship with Cisco – its biggest customer before EMC.
- 28

1 95. On September 10, 2009, STEC issued a letter responding to an
2 August 28, 2009 comment letter from the SEC that inquired, in part, regarding
3 whether STEC was “substantially dependent” on EMC. In that letter, which was
4 publicly filed with the SEC, STEC stated, in part:

5 [I]n the unlikely event a customer should default under a purchase
6 order or other sales agreement, STEC generally believes it could find
7 a replacement customer for the relevant product. STEC additionally
8 could enter into a sales agreement with a new customer which would,
9 in turn, reduce the corresponding percentage of revenues attributable
10 to ongoing customers during a specific period.

11 STEC recognizes the loss of a customer or a significant reduction in
12 purchases by a customer could impact revenues. STEC does not
13 believe, however, that its business would be fundamentally altered
14 without a specific customer sales agreement to suggest the Company’s
15 business is substantially dependent upon that agreement.

16 96. STEC reiterated this contention in a second letter to the SEC, dated
17 October 13, 2009. In that publicly filed letter, STEC stated again that: “STEC does
18 not believe that it was substantially dependent upon the underlying agreements in
19 place with these customers”

20 97. In truth, EMC accounted for 90% of STEC’s sales of Zeus and
21 approximately half of STEC’s overall revenue. However, by the time STEC sent
22 this October letter to the SEC, still undisclosed to investors, the Company had
23 already accrued \$1.5 million in expenses for a joint marketing project designed to
24 assist EMC in selling its excessive inventory of STEC products. At the time these
25 statements were made, Defendants knew or deliberately disregarded that EMC
26 would have an inventory carryover in 2010 that would reduce STEC’s sales and
27 would force STEC’s revenues to suffer significantly for at least the first quarter of
28 2010. In fact, STEC eventually announced that its 1Q10 revenue would be as

1 much as 53% lower than Wall Street's expectations as a result of oversupplying
2 inventory to EMC.

3 D. STEC's Product Quality

4 98. In STEC's July 16, 2009 press release, STEC stated:

5 The STEC ZeusIOPS SSD product family offers a comprehensive
6 array of options for enterprise system architects. ZeusIOPS SSD
7 provides a wide range of interface options, spanning Fibre Channel to
8 SAS to SATA, as well as the widest range of capacity options,
9 spanning 73GB to 1TB. Fundamental to the ZeusIOPS product
10 family is the proprietary SSD architecture which renders an
11 enterprise-optimized storage device *with an unprecedented*
12 *combination of performance and energy efficiency.*

13 99. In addition, STEC's 2Q09 Form 10-Q stated:

14 Our products are designed specifically for storage systems and servers
15 that run applications requiring a high level of input/output operations
16 per second, or IOPs, performance, capacity, *reliability* and a low
17 amount of latency.

18 100. The foregoing statements touting the quality and reliability of STEC's
19 products were materially false and misleading when made because, as detailed
20 herein, Zeus was not an "enterprise-optimized storage device with an
21 unprecedented combination of performance and energy efficiency" nor was it
22 "reliab[le]." In truth, Defendants knew or deliberately disregarded that STEC's
23 customers had trouble integrating Zeus with their systems. Moreover, STEC's
24 products, including Zeus, had material problems including, *inter alia*, unusually
25 high failure rates, bugs, software issues, hardware wear leveling, thermal problems,
26 poor coding, problems with the controllers, and battery problems.

1 E. STEC's Competition

2 101. During STEC's August 3, 2009 earnings conference call, Defendants
3 emphasized that STEC had no competition. Specifically, Defendants represented
4 the following:

5 [MANOUCH MOSHAYEDI:] We think that go forward – on a go-
6 forward basis, our margins business I think will remain in the 50 to
7 60% area. As you know, *we have no competition at this stage*. In
8 addition to that, the current hard drive manufacturers in the enterprise
9 area are still making upwards of 40% margin in that business. So we
10 feel that even going forward, if we have competition in the area of
11 enterprise, with moving to Malaysia, with combination of changing
12 our FPGAs to ASIC next year, and also the capacity that we've built
13 in Malaysia and being able to build all of these – streamline all of the
14 buildings of the SSDs, I think we will be able to maintain about 50%
15 margin for ZeusIOPS. And as ZeusIOPS grows to be the biggest part
16 of our sales, I think we'll maintain the same type margins.

17 102. Also on the August 3, 2009 call, Defendant Manouch Moshayedi
18 stated that the probability of another company coming out with a product like
19 ZeusIOPS was “zero.”

20 103. On August 3, 2009, pursuant to Form S-3ASR, STEC filed a
21 Registration Statement with the SEC for the offering of the Moshayedis' personally
22 held shares of STEC. The Registration Statement was signed by Defendants
23 Manouch Moshayedi, Mark Moshayedi, and Cook, and certain directors.

24 104. The Company filed a Prospectus for the offering with the SEC on
25 August 7, 2009, which was incorporated into the Registration Statement filed on
26 August 3, 2009. The Prospectus also incorporated by reference the 2Q09 Form
27 10-Q, in addition to other SEC filings. The Prospectus included the following
28 representations that it would be difficult for competitors to catch up with STEC:

1 We believe that we are a technology leader in solid-state storage due
2 to our nearly 20 years of focus on advanced memory solutions.
3 Throughout our history, we have delivered advanced memory and
4 storage solutions to a wide range of customers in various market
5 segments, and we continue to develop products to meet the need of
6 enterprises to constantly improve the retention of, and access to,
7 critical data at high performance levels.

8 **Our solutions**

9 The key features of our products include:

- 10 • *Proprietary controller IC technology.* In order to be first-to-
11 market with innovative storage technologies, we design the
12 fundamental logic for our SSD products. The controllers
13 within our various SSD products are the key to enabling
14 high levels of performance and reliability.
- 15 • *High degree of customization.* Products sold to our
16 customers are typically customized by our design and
17 engineering teams to meet our customers' specific design
18 requirements.

19 * * *

- 20 • *High reliability.* Our products are built utilizing
21 sophisticated error detection and correction processes to
22 provide high data reliability and integrity. In addition, our
23 products are designed to withstand high levels of shock and
24 vibration as well as extreme temperature fluctuations.

25 105. These statements were materially false and misleading when made.
26 STEC's products did not have "high levels of performance and reliability" or
27 "meet . . . customers' specific design requirements." In truth, Defendants knew
28 and/or deliberately disregarded that STEC's customers had difficulty integrating

1 STEC's products, received faulty products with high failure rates, were promised
2 product features that STEC never delivered, and were expected to adjust their
3 products and test STEC's products by trial and error, rather than receiving products
4 that met those customers' design requirements.

5 106. Furthermore, STEC's products did not "utilize[] sophisticated error
6 detection and correction processes" or "provide high data reliability and integrity."
7 In truth, Defendants knew and/or deliberately disregarded that STEC's products
8 were unreliable and entire orders frequently had to be shipped back to STEC for
9 error detection, after which STEC would lie about the quantity and type of errors.
10 Further, certain STEC customers were expected to test out several versions of a
11 product to see what worked when STEC lacked the ability to do a failure analysis.

12 107. Nor did STEC's products "withstand . . . extreme temperature
13 fluctuations." In truth, Defendants knew and/or deliberately disregarded that
14 STEC's products failed environmental tests, failing immediately under any high
15 temperature, and Defendants lied to customers about the products' certification.

16 108. In truth, Defendants knew and/or deliberately disregarded that
17 competition would likely enter the market within the next six months. For
18 example, Defendants knew and/or deliberately disregarded that STEC's
19 competitor, Pliant Technology, had begun sampling an enterprise SSD with
20 customers and expected an initial qualification in the fourth quarter. They also
21 knew and/or deliberately disregarded that other competitors, such as Hitachi, were
22 on track to qualify its SSD in early 2010. Defendants knew this and other
23 information showing actual competition at least as early as July 2, 2009, when an
24 industry-specific website, Enterprise Storage Forum, published an article entitled
25 "Solid State Drive Developers Try To Catch STEC."

26 109. Defendants also knew or deliberately disregarded that STEC faced the
27 risk that its customers would seek new vendors to develop and qualify better
28 products, and not continue its relationship with STEC if it continued to "ship